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SIX ESSAYS ON SECURITIES FRAUD AND FINANCIAL CRIME

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ABSTRACT

This article aims to connect six seemingly disparate topics into a single theme. The idea behind these six essays is to guide the reader from Arthur Levitt's desire to more rigorously regulate financial companies and their auditors to an example contained in the 1987 movie Wall Street, where excessive greed ran its course and landed both the protagonist and the antagonist in prison. The first essay describes Arthur Levitt's talk on the number games of earnings management. The second essay discusses the notion of materiality, and why it matters when dealing with violations of the law. The third essay addresses the issues surrounding liability in the financial sector, while the fourth essay provides practical advice on what to do if one receives a subpoena from the Securities and Exchange Commission. The fifth essay focuses on the factors that can potentially make payment for order flows legal or illegal. The final essay highlights possible insider trading violations in the 1987 movie Wall Street. The six essays explore various topics that may bear on the financial creativity of individuals to seek ever-greater profits and what happens when they violate the law.

Keywords: Liability Theories, Materiality, Numbers Game, Order Flows, Subpoena Issues, Wall Street

INTRODUCTION

This article aims to connect six seemingly disparate topics into a single theme. The point of these six essays is to guide the reader from Arthur Levitt's desire to more rigorously regulate financial companies and their auditors to an example contained in the 1987 movie *Wall Street*, where excessive greed ran its course and landed both the protagonist and the antagonist in prison. The six essays explore various topics that may bear on the financial creativity of individuals to seek ever-greater profits and what happens when they violate the law. As already stated, the first essay describes Arthur Levitt's talk on the number games of earnings management. The second essay discusses the notion of materiality, and why it matters when dealing with violations of the law. The third essay addresses the issues surrounding liability in the financial sector, while the fourth essay provides practical advice on what to do if one receives a subpoena from the Securities and Exchange Commission (SEC). The fifth essay focuses on the factors that can potentially make payment for order flows (PFOF) legal or illegal. The final essay highlights possible insider trading violations in the 1987 movie *Wall Street*.

The takeaway from these essays is that even though the law is seemingly static in the short run, the originality and imagination of financial players to garner increasing profits is exemplified in the essays on order flows and the workings of Wall Street. Individuals seek profits in aren as where a slight edge over the competition may result in substantial profits both in the short run and in the long run. The linkage between the essays will hopefully stretch the ingenuity and resourcefulness of investors and other market players. If anything, these six essays may demonstrate the vision of financial players and regulators, where inventiveness is likely the order of the day and finance never sleeps.

ESSAY #1: THE NUMBERS GAME

The purpose of this essay is to discuss Arthur Levitt's 1998 speech entitled, *The Numbers Game*, and explain its possible effects on the Enron Corp. and WorldCom Inc. scandals. The paper argues that had the senior management of these two firms paid attention to the content of Levitt's speech, they could have avoided their financial losses and bankruptcies. It should be remembered that Levitt gave the speech in 1998 and that there was plenty of time (three and four years respectively) for the senior managers to recognize that their companies would be targeted by the Securities and Exchange Commission (SEC). Unfortunately, by not paying attention to the change in direction by the SEC, Enron and WorldCom fell victim to excessive greed, where only profits mattered, and integrity took a back seat.

Arthur Levitt's Speech

On September 28, 1998, Arthur Levitt, the former chairperson of the SEC spoke before the New York University (NYU) Center for Law and Business.[1] In the speech, Levitt discussed the custom of earnings management and the following illusions that accounting firms employ to obscure financial volatility:[2]

- Big Bath restructuring charges;
- Creative acquisition charges;
- Cookie jar reserves;
- Immaterial misapplication of accounting principles; and
- Premature recognition of revenue.

Levitt observed that Big Bath accounting charges are overstating their restructuring charges to give investors the impression the firm is cleaning up its balance sheet.[3] Creative acquisition accounting occurs when a portion of the acquisition price is classified as in-process research and development.[4] Cookie jar reserves, such as sales returns, loan losses, or warranty costs, exist because companies

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[1]Arthur Levitt, The "Numbers Game", *U.S. Securities and Exchange Commission* (Sep. 28, 1998), *available at* https://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.
[2]*Id.*
[3]*Id.*
[4]*Id.*

employ unrealistic assumptions to estimate liabilities.[5] The immaterial misapplication of accounting principles (a.k.a., materiality) occurs when companies intentionally record errors, where the errors are less than a pre-defined maximum.[6] This is a significant issue because if the percentage ceiling of errors is too high (e.g., 6 percent), the effect may cast a company in a much better light than what it really is.[7] Finally, to increase earnings, companies recognize revenue before it is appropriate to do so, particularly when sales revenue before a sale is complete.[8]

To improve the accounting framework, Levitt suggested the following nine changes to accounting standards:[9]

- Require well-detailed disclosures about changes in accounting assumptions;
- Work with the American Institute of Certified Public Accountants (AICPA) to clarify the ground rules for auditing purchased research and development;
- Reject the idea that materiality can be employed to excuse deliberate misstatements of performance;
- Review interpretative accounting guidance in the software and other service sectors;
- Ask the Financial Accounting Standards Board (FASB) to take prompt action when current standards and guidance are inadequate;
- Target public companies that announce restructuring liability reserves, major write-offs, or other practices that seem to manage earnings;
- Ensure that auditors focus on integrity rather than cost-effectiveness or competitive advantage in the audit process;
- Create a "blue ribbon" panel to develop a sequence of far-reaching recommendations to empower audit commissions; and
- Embrace a cultural change where the integrity of financial numbers is paramount, where punishment is meted out to deceptive violators.

Although numbers are abstractions, Levitt suggested that companies as well as the SEC must rededicate themselves to the fundamental principle that "markets exist through the grace of investors."[10] Levitt opined that it is the only way to ensure that global confidence in American financial markets can be maintained.[11]

Enron Scandal

Enron Corp. (Enron) was an American energy, commodities and services firm that was headquartered in Houston, Texas and was founded in 1985 by Kenneth Lay.[12] Before its bankruptcy, Enron employed tens of thousands of employees and its stock price went from $ 90.75 at its peak to $ 0.26 at bankruptcy.[13] Enron employed a variety of deceptive accounting practices to hide significant liabilities from its financial statements. Essentially, when the firm experienced losses, it created entities that assumed the losses so that the losses did not affect the Enron balance sheet, thereby making Enron appear profitable when it was experiencing losses.[14] This action increased the company's stock price so that senior managers could use insider information to trade millions of dollars of Enron stock. This use of off-balance sheet entities to hide losses made its balance sheet an inconvenient document and permitted the firm to act as a Ponzi scheme or financial pyramid, where the firm needed a continuous infusion of capital to keep it afloat.[15] Enron violated several of Levitt's five principles. First, the firm employed creative accounting to not record losses on its balance sheet by off-loading the losses to another entity. Second, Enron may have violated the materiality principle by ignoring its losses on its balance sheet by allowing a wholly-owned entity to record the losses on its balance sheet, thereby giving the illusion that Enron was profitable when it was not. Finally, Enron performed the opposite of recording revenue before its time. The company failed to recognize losses on its balance sheet when it off-loaded its losses to other entities.

Had senior management heeded Levitt's warnings and judiciously applied his five principles effectively, it is likely that Enron would not have declared bankruptcy. If it had declared bankruptcy, it may have been able to restructure its debt (Chapter 11) rather than completely going out of business (Chapter 7). Levitt's speech occurred in 1998, approximately three years before Enron's bankruptcy. Enron's senior management would have been well-advised to have paid attention to Levitt's speech. Had they done so, the Enron senior management would have recognized that the writing was on the wall and that sooner or later the SEC would go after the firm. It was just a matter of time.

WorldCom Scandal

WorldCom, Inc. (WorldCom or MCI WorldCom) was the second-largest telecommunications company in the United States. The company expanded by acquiring other telecommunications firms, including MCI Communications in 1998.[16] The company filed Chapter 11 bankruptcy due to an accounting scandal whereby several executives, including Bernard Ebbers, an early investor, were convicted of inflating corporate assets.[17] In January 2006, the company, then named MCI, was acquired by Verizon Communications, and integrated into Verizon Business. From September 2000 and April 2002, WorldCom's board of directors authorized several loans and loan guarantees to its Chief Executive Officer (CEO), Bernard Ebbers so that he could meet his margin calls.[18] The loans prevented Ebbers from selling his WorldCom stock to satisfy his financial obligations during the dot-com bubble.[19] As the board of directors became increasingly frustrated with Ebbers, John W. Sidgmore, the former CEO of UUNET Technologies (UUNET), replaced him. The board consolidated into a single $ 408.2 million promissory note.[20] In 2003, Ebbers defaulted on the note and WorldCom foreclosed on many of his assets.[21]

Beginning in 1999 and continuing through May 2002, Ebbers, the Chief Financial Officer (CFO) Scott Sullivan, Controller David Myers,

[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] Troy Segal, Enron Scandal: The Fall of a Wall Street Darling, *Investopedia* (Apr. 5, 2023), *available at*https://www.investopedia.com/updates/enron-scandal-summary/.
[13] Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations, *U.S. Congress* (Feb. 2003), *available at* https://web.archive.org/web/20200928104439/http://www.jct.gov/s-3-03-vol1.pdf.

[14] Forbes Staff, Enron the Incredible, *Forbes* (Jan. 15, 2002), *available at* https://www.forbes.com/2002/01/15/0115enron..?sh=763d7d533c9c.
[15] Shaheen Pasha, Skilling Comes Out Swinging, *CNN Money* (Apr. 10, 2006), *available at* https://money.cnn.com/2006/04/10/news/newsmakers/enron_trial/index.htm.
[16] Adam Hayes, The Rise and Fall of WorldCom: The Story of a Scandal, *Investopedia* (Aug. 29, 2023), *available at*https://www.investopedia.com/terms/w/worldcom.asp.
[17] *Id.*
[18] USA Today Staff, Ebbers $400M Loans from WorldCom, USA Today (Nov. 5, 2002), available at http://usatoday30.usatoday.com/money/industries/telecom/2002-11-05-ebbers-loans-timeline_x.htm.
[19] *Id.*
[20] *Id.*
[21] "Worldcom, Inc. 2002 Form 10-K Annual Report". *U.S. Securities and Exchange Commission* (2002), *available at* https://www.sec.gov/Archives/edgar/data/723527/000119312504039709/d10k.htm.

and General Accounting Director Buford Yates used the following fraudulent accounting methods in inflate the firm's stock price:[22][23]

- Booking line costs (interconnection expenses with other telecommunication companies) as capital expenditures on the balance sheet instead of expenses;
- Inflating revenues with bogus accounting entries from corporate unallocated revenue accounts;
- The use of reserves to boost the company's income;
- Employing complicated accounting terms (such as prepaid capacity), which were used to hide the movement of capital; and
- The lack of evidence to substantiate certain financial transactions, including a $ 500 million capital expenditure.

WorldCom declared Chapter 11 bankruptcy on July 21, 2002.[24] At the time, the firm owed its creditors approximately $ 7.7 billion, where the company possessed $ 107 billion in assets and $ 41 billion in debt.[25]

WorldCom may also have violated several of Levitt's principles. First, the firm likely used creative accounting by booking line costs as capital expenditures rather than expenses as well as employing complicated accounting terms whose meanings were questionable. Second, WorldCom likely created cookie jar reserves to reduce its liabilities. Third, WorldCom probably employed materiality gimmicks to ensure that the looked better than it was. Finally, the company inflated revenues and could not substantiate specific financial transactions. Like Enron, WorldCom would have been well-advised to have listened to Levitt's talk. There was time to listen, as the WorldCom bankruptcy occurred in 2002, four years before Levitt gave his speech. Had WorldCom's senior management done so, the company's Chapter 11 bankruptcy may have been avoided.

Essay #1 Conclusion

In conclusion, the morale of Enron and WorldCom stories is that companies should pay attention to the speeches of the chairperson of the SEC. Firms should likely have a department whose sole task is to review the policy statements of the government agencies that have legal power over them. Understandably, many business people consider the federal government their enemy rather than their friend. Even so, a healthy respect for the workings of governmental organizations is prudent. One never knows when a government bureau will investigate the workings of a firm.

ESSAY #2: MATERIALITY

This essay aims to discuss how the qualitative factors in SEC Staff Accounting Bulletin No. 99 (SAB 99) impact the determination of materiality and whether William Duhnke's removal from the Public Company Accounting Oversight Board (PCOAB) by the Security and Exchange Commission (SEC)'s chairperson Gary Gensler was consistent with SAB 99. The paper first provides several definitions of materiality from an accounting perspective. Second, the piece lists the qualitative factors that were listed in SAB 99. Third, the removal of William Duhnke by the SEC chairperson Gary Gensler is discussed. Finally, the paper concludes by observing that Duhnke could have been removed because he was "soft" on auditors and auditing firms as advocated by Sen. Elizabeth Warren and Bernie Sanders, or because Duhnke was appointed by Pres. Trump, the Biden Administration was purging all things Trump. The paper concludes that given the current information, no definite conclusions can be drawn.

Definition of Materiality

According to the Harvard Business School, materiality is "an accounting principle which states that all items that are reasonably likely to impact investors' decision-making must be recorded or reported in detail in a business's financial statements using Generally Accepted Accounting Principles (GAAP) standards."

[26]Louis observed that in August 2018, the Financial Accounting Standards Board (FASB) changed the definition of materiality to encompass "[m]isstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements."[27] The Indeed Editorial Team provided an operational definition of materiality by opining that "[m]ateriality in accounting refers to the relative size of an amount, and the impact it makes on the financial statements," where"[i]n the accounting process, accountants deem relatively large sums of money to be material . . . they have a significant impact on the company's finances."[28] This definition is an operational definition accountants tend to employ their professional judgment in deciding whether small amounts of money are immaterial.[29] In contrast, the Securities and Exchange Commission (SEC) Staff observed that "[t]he omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."[30] It should be noted that the definition of materiality from Indeed differs significantly from the definition provided by the SEC Staff. The SEC Staff maintained that small amounts can be material under various circumstances because qualitative factors may dictate that an amount is material even though its impact on the financial statements of a firm is relatively small.[31] In particular, the SEC Staff rejected the notion that a numerical threshold, such as five percent (5%), should not be employed without taking into consideration other relevant factors.[32]

Qualitative Factors that Determine Materiality

According to the SEC Staff, the qualitative factors that should be considered when deciding where an amount is material include whether a misstatement:[33]

- Can be precisely measured;
- Must be estimated with a specific degree of precision;
- Masks a change in earnings or other trends;

[22]*Id.*
[23]Adam Hayes, *supra*, note 16.
[24]*Id.*
[25]*Id.*

[26]HBS Online Staff, What Is Materiality in Accounting and Why Is It Important?,*Harvard Business School Online* (Sep/ 07, 2021), *available at* https://online.hbs.edu/blog/post/what-is-materiality#:~:text=Materiality%20is%20an%20accounting%20principle,financial%20statements%20using%20GAAP%20standards.
[27]Jennifer Louis, What Is Materiality? The AICPA Definition of Materiality Changes, *Becker* (Jan. 14, 2020), available at https://www.becker.com/blog/accounting/aicpa-adopts-new-definition-of-materiality.
[28]Indeed Editorial Team, What Is Materiality in Accounting? (Definition and Examples), *Indeed* (Sep. 30, 2022), *available at* https://uk.indeed.com/career-advice/career-development/materiality-in-accounting#:~:text=Materiality%20in%20accounting%20refers%20to,impact%20on%20the%20company's%20finances.
[29]*Id.*
[30]SEC Staff, No.99 – Materiality, *U.S. Securities and Exchange Commission* (Aug. 12, 1999), *available at* https://www.sec.gov/interps/account/sab99.htm.
[31]*Id.*
[32]*Id.*
[33]*Id.*

- Hides a failure to meet analysts' consensus expectations for the organization;
- Changes a loss into income or vice versa;
- Concerns a segment or portion of the registrant's business that plays a significant in its profitability;
- Affects the registrant's compliance with regulatory requirements;
- Addresses the registrant's compliance with loan covenants or contractual requirements;
- Increases management's compensation (e.g., bonuses, stock options, etc.); or
- Involves concealment of an unlawful transaction.

The SEC Staff correctly observed that the list above is likely incomplete and not exhaustive.[34] The SEC Staff opined that the volatility of a registrant's stock price may be affected by the types of disclosures that may guide management on whether a small misstatement is material.[35] A small misstatement can be thought of as material if it is the basis for a significant positive or negative market reaction.[36]

Removal of William Duhnke

On June 04, 2021, Gary Gensler, who became the head of the SEC in April 2021, removed William Duhnke III as chair of the PCAOB.[37]Duhnke was the head of the SEC since January 2018 during the Trump administration.[38] The PCAOB was created by the Sarbanes Oxley Actof 2002 (SOX) but has been criticized by Democrats as being toothless.[39] Previously, Sen. Elizabeth Warren (D-MA) and Sen. Bernie Sanders (I-VT) pressured the SEC to replace the board, saying that the board should "keep publicly-traded companies in check."[40] In contrast, the Republican members of the SEC, Hester Peirce and Elad Roisman, observed that Duhnke's removal established a "troubling precedent."[41] However, during the Trump administration in 2017, Jay Clayton, the SEC chairperson before Duhnke, appointed five new members to the PCOAB after the board's staff leaked confidential information to one of the audit firms it administers.[42] According to Rep. Patrick McHenry (R-North Carolina), the vote to remove Duhnke was along party lines.[43] According to McHenry, the removal of Duhnke was a deliberate attempt by the Biden Administration to erode the independence of the PCOAB.[44]

According to Ho, Chairperson Gensler avoided answering a question about whether SOX should be amended to ensure that disciplinary proceedings against an auditor or audit firm should be made public.[45] Sections 105(c)(2) and 105(d)(1)(C) of SOX prevent the board from making the proceedings of the PCOAB public, unless there is a reason to open up the proceedings or the auditor or auditing firm agrees.[46] There is a positive probability that the American Institute of Certified Public Accounts (AICPA) and the Big Four account ting firms have successfully lobbied against this amendment.[47] The idea behind the non-public nature of the proceedings is likely that it prevents a second Arthur Anderson debacle, where an auditor or auditing firm is tried in the court of public opinion and not in a court of law.

Essay #2 Conclusion

In conclusion, whether the qualitative factors listed above played a role in the removal of Duhnke is an open question. If one believes the PCOAB criticism from Sen. Warren and Sen. Sanders, then it appears that Duhnke was likely removed because he failed to ensure the independence of the board and was "soft" on auditors and auditing companies. In other words, Duhnke's removal was a step in the right direction. However, if Duhnke's removal occurred because he was appointed by Pres. Trump, and Pres. Biden wanted to erase the influence of Pres, Trump's appointees in government, then Duhnke's removal was purely political and Rep. McHenry's appraisal of Duhnke's removal was probably correct. The truth will likely not be known except by the starring characters in the drama, and because of SOX, they are not telling. In America these days, this is the world we live in.

ESSAY #3: LIABILITY THEORIES

In this essay, three theories of insider trading liability will be discussed. The first theory will be the Section 16(a) theory of the Securities Exchange Act of 1934 (SEA34). The second theory is known as the classical or traditional theory, where only corporate insiders can be prosecuted for insider trading. The third theory to be discussed is the misappropriation theory. The piece then highlights why Congress enacted the element of Section 16(a). The conclusion opines that the work of Congress was for the benefit of stockholders and other investors.

Theories of Liability

In this section, three theories of liability will be discussed. The first theory is the theory underlying Section 16(a) of SEA34. The second theory is the classical theory of liability followed by the misappropriation theory of liability. Each theory will be presented in turn.

Section 16(a) of the Exchange Act

Section 16 of SEA34 lists the regulatory filing requirements of directors and principal stockholders.[48] Section 16 creates filing standards for insiders who possess corporate stock and may directly or indirectly if they own at least 10 percent of common stock or other equity class.[49] Section 16 also applies to fixed-income securities or bond investors that trade on a national stock exchange.[50] Any person who is an insider must file specific forms with the SEC disclosing their interests, where the documents also show how the insider's investment position has changed over time.[51]According to Section 16,

[34]*Id.*
[35]*Id.*
[36]*Id.*
[37]Katanga Johnson & Chris Prentice, U.S. SEC Ousts Head of Accounting Watchdog, Puts Rest of Board on Notice, *Reuters* (Jun. 04, 2021), *available at* https://www.reuters.com/business/us-sec-ousts-head-accounting-watchdog-puts-rest-board-notice-2021-06-04/.
[38]*Id.*
[39]*Id.*
[40]*Id.*
[41]*Id.*
[42]*Id.*
[43]Patrick McHenry, Letter to the Hon. Gary Gensler, *U.S, House of Representatives* (Jun. 08, 2021), *available at* https://financialservices.house.gov/uploadedfiles/2021-06-08_pmc_to_gensler_-_pcaob_preservation_request.pdf.
[44]Patrick McHenry, Announcing Investigation, McHenry Instructs the SEC & PCAOB to Preserve Documents Regarding Move to Politicize an Independent PCAOB, *U.S. House of Representatives: Financial Services Committee* (Jun. 09, 2021), *available at* https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408012.
[45]Soyoung Ho, SEC Chair Gensler Gives Ambiguous Response to Whether PCAOB Disciplinary Proceedings Should be Made Public, *Reuters* (Aug. 03, 2022), *available at* https://tax.thomsonreuters.com/news/sec-chair-gensler-gives-ambiguous-response-to-whether-pcaob-disciplinary-proceedings-should-be-made-public/.
[46]*Id.*
[47]*Id.*
[48]James Chen, Section 16 Definition and SEC Filing Requirements, *Investopedia* (Nov. 20, 2020), *available at* https://www.investopedia.com/terms/s/section-16.asp.
[49]*Id.*
[50]*Id.*
[51]*Id.*

an individual may be a beneficial owner even if they have no equity interest in a firm.[52] For example, if a person is a member of a shared household where an immediate family member owns securities in a company, that person is subject to Section 16 filing requirements.[53]

Classical Theory of Liability

With the classical or traditional theory of insider trading, a Section 10(b) violation occurs when an individual employed by a company trades corporate stock based on material, non-public information that was obtained because of the person's position within the firm.[54] The trading is a deceptive practice because a relationship of trust exists between corporate shareholders and the individual, where the insider must disclose or not trade corporate stocks.[55] The classical or traditional theory applies to officers, directors, and other permanent insiders, along with attorneys, accountants, consultants, and other individuals who may be temporary fiduciaries of the company.[56] The classical theory focuses on a corporate insider's breach of duty to a company's shareholders, not an insider's duty to the source of the inside information, as in the misappropriation theory discussed below.[57]

Misappropriation Theory of Liability

The misappropriation theory of insider trading occurs when "an individual trades stock in a corporation, with whom they are unaffiliated, on the basis of material non-public information they obtained through a breach of a fiduciary duty owed to the source of the information."[58] In contrast to the classical or traditional perspective on insider trading, the misappropriation theory does not demand that a seller possess a fiduciary duty to the firm whose stock they trade.[59] The fact that a seller has inside information is sufficient to generate liability under Rule 20b-5.

Prior to *O'Hagan*, an individual could be liable for insider trading only under the classical or traditional theory.[60] Under the classical or traditional theory, the attorney could not have been prosecuted because he was not an employee of Pillsbury, the company whose stock was traded.[61] In *O'Hagan*, the Supreme Court (SCOTUS) observed that a partner of a large law firm bought corporate stock futures predicated on the inside information that was obtained from other law firm partners who were involved with the company.[62] There was no fiduciary duty between the attorney and the firms whose stock he was trading.[63] Even so, SCOTUS found the attorney liable under Rule 10b-5, opining that the senior partner behaved fraudulently because his behavior was similar to embezzlement, where the owner of the confidential information had exclusive use of the information.[64] The attorney did not disclose to the owner that he was trading on the information.[65] After *O'Hagan*, the Securities and Exchange Commission codified the misappropriation by creating Rule 10b-1, prohibiting trading based on material, non-public information.[66]

Congressional Motivation for Section 16(a) Elements

Section 16(a) applies to insiders (i.e., officers, directors, and 10 percent equity holders) of publicly traded companies.[67] They must file (1) Form 3 within 10 business days of becoming an insider, (2) Form 4 within 2 business days of a change in beneficial ownership, and (3) Form 5 annually to report any insider transactions that were not previously reported on Form 4.[68]

On September 10, 2014, the SEC announced that it was enforcing Section 16(a) violations against 34 companies for not filing Section 16(a) reports and Schedules 13D and 13G, or disclosing insider violations in their Proxy Statement per Item 405.[69] Thirty-three of the 34 companies settled with cease-and-desist orders and monetary penalties ranging from $ 25,000 to $ 150,000.[70] The SEC employed quantitative data sources and ranking algorithms to discover the insiders repeatedly filed late by weeks, months, and in some cases, years.[71] The enforcement actions appeared without warning after more than 10 years of low enforcement activity.[72]

According to Winston Strawn, the SEC sent a strong enforcement message to the business community that there is a need for timely filings, where the SEC was likely to reveal their new statistical monitoring capabilities.[73] The lessons learned from the SEC actions should be that insiders should be diligent in reporting their stock purchases and sales, while firms should give Section 405 disclosures the same consideration as the rest of the Proxy Statement.[74] In this author's opinion, the SEC is demonstrating that it wants companies to pay close attention to its rules and regulations, and not play fast and loose with them.

Essay #3 Conclusion

In conclusion, the motivation for Congress in enacting each of the elements necessary to prove a violation of Section 16(a) is to ensure that companies are behaving in the best interests of stockholders, not withholding information that is beneficial to investors. It should be remembered that when senior managers buy or sell the stocks of their firms before a significant event, it may be a signal that the event will occur in the very near future. Investors deserve to be notified, if not directly, then indirectly, that a company's stock price may dramatically change. It is fair to stockholders, and senior managers have a duty to be transparent and fair.

ESSAY #4: SUBPOENA ISSUES

The goal of this essay is to discuss what advice to give to the board of directors after the firm has received a subpoena from the Securities and Exchange Commission (SEC). In general, the company should diligently safeguard its rights, while at the same time obeying the terms and conditions of the subpoena, Above all, the entity should

[52]*Id.*
[53]*Id.*
[54]*Chiarella v. United States*, 445 U.S. 222, 228-29.
[55]*Id.*
[56]*Dirks v. Securities and Exchange Commission*, 463 U. S. 646, 655, n. 14 (1983).
[57]*United States v.* O'Hagan, 521 U.S. 642 (1997), available at
[58]LII Staff, Misappropriation Theory, *Legal Information Institute* (n.d.), available at https://www.law.cornell.edu/wex/misappropriation_theory_of_insider_trading#:~:text=The%20misappropriation%20theory%20of%20insider,the%20source%20of%20the%20information.
[59]*Id.*
[60]*United States v. O'Hagan,* 521 U.S.,*supra*, note 57.
[61]*Id.*
[62]*Id.*.
[63]*Id.*
[64]*Id.*
[65]*Id.*

[66]*Id.*
[67]WS Staff, "Broken Window" Filings: How to Avoid SEC Section 16 Problems for Officers, Directors, Public Companies and Principal Stockholders, *Winston Strawn* (Oct. 23, 2014), *available at* https://www.winston.com/a/web/90099/90099.pdf.
[68]*Id.*
[69]*Id.*
[70]*Id.*
[71]*Id.*
[72]*Id.*
[73]*Id.*
[74]*Id.*

seek the advice of legal counsel who are well-versed in SEC subpoenas and attorney-client privilege.

Definition of Material, Non-Public Information

Material non-public information is “data relating to a company that has not been made public but could have an impact on its share price.”[75] It is illegal for individuals who hold non-public material information to employ advantageously the information in trading stocks.[76]Material non-public information cannot be legally shared with others who use it to profit in the stock market.[77] Material non-public information is also known as insider information, which is important information that is not to be disclosed to the public because the information may affect the stock price of a company.[78] The Dun & Bradstreet Rating Service (DBRS) defined material non-public information as “[i]nformation that has not been disclosed in such a way as to achieve a broad dissemination to the investing public generally, and: (i) if it were publicly known, that information would or would reasonably be expected to result in a significant change in the market price or value of a traded security; or (ii) there is a substantial likelihood that a reasonable investor would consider that information important in making an investment decision.”[79]

Subpoena from the Securities and Exchange Commission

A subpoena from the SEC is a “legal order for recorded testimony that is issued by the [SEC] in connection with one of its investigations. The subpoena requests documents, data, or both which are relevant to an ongoing investigation.”[80] The two types of SEC subpoenas are a *subpoena ad testificandum* and a *subpoena duces tecum*.[81] A *subpoena ad testificandum* is a subpoena that “compels the person to whom it is addressed to appear at a specific time and place and testify under oath or affirmation,” whereas a *subpoena duces tecum* is a subpoena that “compels the person to whom it is addressed to produce documents in his possession or control, either at a designated location or before the person who signed the subpoena.”[82]

From the perspective of corporate counsel or chief of compliance, it is imperative to know what kind of subpoena was received from the SEC. The reason is that if a *subpoena ad testificandum* was received from the SEC, the company is required to produce an individual to testify before the Commission. A person has the right to legal counsel independent of corporate counsel. It should be remembered that corporate counsel’s client is the firm, not the individual who is being compelled to testify. The corporation may or may not have contracted with the individual required to testify to provide legal counsel for them or pay their legal fees. If the individual is a senior manager or a director, such a contract likely exists. On the other hand, if the person is a middle manager or an individual contributor, it is far more probable that such a contract does not exist. Legally, such an individual is on their own.

If the subpoena is a *subpoena duces tecum*, then the firm is only required to give up documents and records to the SEC. On its face, this action may seem innocent, but once the SEC has the requested documents, the SEC will likely pursue legal action against the company, a senior manager, a director, a middle manager, or an individual contributor. Given that there is a significant probability of a suit once the documents and records are in the SEC’s possession, the firm should be careful to give to the SEC exactly what it has requested, nothing more and nothing less. The company must not disclose to the SEC any documents or records that are protected under attorney-client privilege, or any other legal privilege for that matter. Independent legal counsel should probably be hired to ensure that the firm safeguards its rights under the law. One thing that ought to occur is that the attorneys for the company and the attorneys for the SEC should meet and discuss the subpoena, establishing the ground rules for what is desired. If there are any disagreements regarding what the SEC wants, the attorneys for the company should file a motion with the court either requesting clarification or even a motion to quash the subpoena if appropriate.

What to Do When Receiving a Subpoena from the SEC?

According to Pierce, here are the steps to be taken when receiving a subpoena from the SEC:[83]

Step 1: Immediately consult an SEC defense lawyer who is experienced with SEC subpoenas. The lawyer will be able to direct the firm through the process, representing the company during the investigation. The lawyer can decide how to respond to the subpoena, what information should be released immediately, and assist the firm in avoiding making any mistakes that could result in substantial legal consequences.

Step 2: The company should know its rights, particularly the rights of privileged information. This includes attorney-client privilege, where the firm is not required to provide any communications between the attorney and the firm, as well as any work products generated by the attorney in connection with the case.

Step 3: Corporate counsel, the chief of compliance, and the firm’s outside counsel should read the terms of the subpoena carefully and thoroughly. The terms and conditions of the subpoena should be well-understood so that the company understands what specific documents are to be turned over to the SEC. It should be remembered that the SEC will review all the documents given to them.

Step 4: The firm through counsel should respond to the subpoena as soon as possible. The documents that are given to the SEC should be reviewed with all reasonable haste. However, it is not advised to hand over documents without first consulting with a lawyer. If a particular document or record is difficult or unrealistic to produce, the SEC should be so informed. It should be remembered that some items may take longer than 30 days to find, depending on where they are located. For example, tens of thousands of old emails may take more than 30 days to produce.

Step 5: The firm should maintain a detailed record of all aspects of the subpoena process, including any contact or communication with an SEC investigator(s). The purpose of this record is to protect the firm in the future with evidence in case there are

[75]James Chen, Material Nonpublic Information (MNPI)? Definition and Laws, *Investopedia* (Apr. 25, 2022), *available at* https://www.investopedia.com/terms/m/materialinsiderinformation.asp#:~:text=Material%20nonpublic%20information%20is%20data,their%20advantage%20in%20trading%20stocks.
[76]*Id.*
[77]*Id.*
[78]Ashish Kumar Srivastav, Material Nonpublic Information Definition, *Wall Street Mojo* (n.d.), *available at*https://www.wallstreetmojo.com/material-nonpublic-information/.
[79]DBRS Staff, Confidential Information Global Policy, *Dunn & Bradstreet Rating Service* (Dec. 1, 2017), *available at* https://www.sec.gov/Archives/edgar/data/1651011/000110465920039986/a20-14087_1ex99de3nrsro.pdf.
[80]Robert Wayne Pierce, How to Handle An Sec Subpoena: Step-by-Step, *Robert Wayne Pierce, P.A.* (Jul. 16, 2023), *available at* https://www.secatty.com/legal-blog/handling-a-sec-subpoena/#:~:text=An%20SEC%20subpoena%20is%20a,relevant%20to%20an%20ongoing%20investigation.
[81]*Id.*
[82]*Id.*
[83]*Id.*

questions regarding what occurred during the investigation process.

Step 6: The company should keep the details of the case confidential between the firm and its legal representation. Above all, do not discuss or share information with anyone who is not an attorney. The company should never incriminate itself.

Step 7: The firm should be proactive, but not engage in any activity that could be construed to be obstruction of justice, lying, or concealing information.

Disclosing the Subpoena to the Public

After receiving the subpoena from the SEC, many companies ask whether to disclose that it is under investigation.[84] A secondary question is to ask how much detail should be disclosed to corporate employees, lenders, insurers, and stockholders. There are no tried-and-true standards for disclosing government investigations, and thus, practices may vary.[85] Some companies disclose investigations on receiving a subpoena, while other firms wait until the investigation process is underway.[86] The entity may wait until it receives a Wells notice, which is a "letter sent by a securities regulator to a prospective respondent, notifying him of the substance of charges that the regulator intends to bring against the respondent, and affording the respondent with the opportunity to submit a written statement to the ultimate decision maker."[87] Finally, cases litigated in federal courts regarding subpoena responses may give companies some additional guidance. For public companies, disclosure is not an automatic response. There are circumstances where disclosure is imperative, and there are other reasons where disclosure is not advisable. Counsel should be involved in helping make a disclosure decision.

Essay #4 Conclusion

In essence, board of directors should consider the issues and follow the steps outlined above. Adhere to the advice of the firm's attorney. And above all, do not break the law or incur additional liability.

ESSAY #5: ORDER FLOWS AND ROBINHOOD

The purpose of this essay is to examine order flows and payment for order flows (PFOF), and whether they are generating security violations. The discussion begins by defining order flows and PFOF and then describing their characteristics. The Robinhood Market, Inc. (Robinhood) case is briefly highlighted. The piece then talks about potential security violations, including market manipulation, insider trading, and best execution. The paper concludes by observing that market manipulation and insider trading are likely minimally affected by PFOF, whereas best execution is a topic that is of vital interest to the Securities and Exchange Commission (SEC).

Order Flows and Payment for Order Flows

In this section, order flows and PFOF are defined. The section then discusses current SEC rule changes. The second section finishes off by describing Robinhood's encounter with the SEC.

Definition of Order Flow

Order flow trading is a trading strategy for analyzing the flow of trades by other investors in a specific market.[88] Order flow trading is accomplished by observing the Order Book and the footprint charts to see what types of orders are being placed at a specific time, and the number of buy and sell orders at a given price.[89] Order flow trading is a form of short-term trading that is employed to enter a market accurately predicated on recently executed buy and sell orders.[90] Order flow trading is also referred to as volume trading.[91]

Definition of Payment for Order Flow

PFOF is a type of compensation, typically in fractions of a penny per share, that a broker may receive for pointing execution orders to a given market maker or exchange.[92] The idea is that a PFOF transfers some of the trading profits from the specialists making a market to the brokers that are routing the orders. PFOF can potentially create unfair or opportunistic conditions where retail traders and investors pay an additional price.[93] The SEC requires brokers to record and disclose to clients the compensation that they receive for routing their orders to a given market maker.[94] The advantages of PFOF are better execution prices and greater market liquidity.[95] A PFOF is a legal transaction provided that both parties satisfy their duty of best execution for the customer that initiates a trade, where the price is no worse than the National Best Bid and Offer (NBBO).[96] The legitimate reason for PFOF transactions is liquidity, not the possibility to profit by delivering an inferior execution price.[97]

Rule Changes for Payment for Order Flow

Even though best execution is intended when executing a PFOF, the SEC has sounded the alarm that a broker and market maker may not be sustaining its obligation for best execution for a customer, where their fears may diminish investor confidence in financial markets. Since 2005, brokers must reveal their PFOF policies and financial relationships with market makers via Regulation NMS when customers first open an account. When requested, a broker must disclose every PFOF that it receives due to SEC Rules 605 and 606.[98] Even so, the Financial Information Forum (FIF) observed that Rules 605 and 606 "do not provide the level of information that allows a retail investor to gauge how well a broker-dealer typically fills a retail order when compared to the [NBBO] at the time the order was received by the executing broker-dealer."[99]

Rule 606 was updated in Q1 of 2020 so that every month brokers were mandated to reveal net payments they received from market makers for equity and options trades. Brokers were also required to reveal their rate of payment for order flow per 100 shares by order

[84]Deborah S. Birnbach, Do You Have to Disclose a Government Investigation?,*Harvard Law School Forum on Corporate Governance* (Apr. 9, 2016), *available at* https://corpgov.law.harvard.edu/2016/04/09/do-you-have-to-disclose-a-government-investigation/.
[85]*Id.*
[86]*Id.*
[87]LII Staff, Wells Notice, *Legal Information Institute* (n.d.), *available at* https://www.law.cornell.edu/wex/wells_notice.
[88]TSG Staff, Oder Flow Trading Strategy: 3 Tips to Create Abundance, *Trading Strategy Guides* (Mar. 18, 2023), *available at* https:.//tradingstrategyguides.com/order-flow-trading-strategy/.
[89]*Id.*
[90]*Id.*
[91]*Id.*
[92]Theresa W. Carey, Payment for Order Flow (PFOF): Definition and How It Works, *Investopedia* (Jul. 04, 2022), *available at* https://www.investopedia.com/terms/p/paymentoforderflow.asp.
[93]*Id.*
[94]*Id.*
[95]*Id.*
[96]*Id.*
[97]*Id.*
[98]*Id.*
[99]FIF Staff, Retail Execution Quality – Overview, *Financial Information Forum* (n.d.), *available at* https://fif.com/index.php/retail-execution-quality/retail-execution-quality-overview.

types, such as market orders, marketable limit orders, non-marketable limit orders, etc. In December 2022, the SEC proposed to update Rule 605 for order execution due to the dramatic changes in technology and market structure. The scheme was to expand transparency, augment competition, and generate quicker executions for larger brokers.[100]Repetto, the Managing Director of Piper Sandler & Co., a New York-based investment bank, summarized the Rule 606 statistics for Charles Schwab, TD Ameritrade, E*TRADE, and Robinhood, where PFOF what higher in Q2 of 2020 than in Q1 of 2020 due to increased trading activity.[101]

The Robinhood Market, Inc. Problem

In 2021, PFOF came into the news when the SEC opined that some brokers were urging their customers to profit from PFOF.[102] In December 2020, the SEC fined Robinhood $65 million for not properly disclosing to its customers the PFOF payments the company received for less than best execution trades.[103] In 2021, SEC Chair Gary Gensler told Barron's that banning PFOF was an option that the SEC was considering.[104] Almost immediately, Robinhood's shares dropped 6.9 percent because PFOF was one of Robinhood's largest sources of revenue.[105] Gensler stated that PFOF, or the back-end payments that brokers receive, have an inherent conflict of interest.[106] When the CNBC staff asked Gensler for more details, Gensler declined to provide more information, even though the SEC Chair said for several months that banning PFOF was an option.[107]

Potential Security Law Violations

The three security law violations that could occur are market manipulation violations, insider trading violations, and best execution violations. Each one will be discussed in turn.

Market Manipulation Violations

Market manipulation occurs when "someone artificially affects the supply or demand for a security (for example, causing stock prices to rise or to fall dramatically)."[108] Market manipulation includes:[109]

- Spreading false or misleading information about a firm;
- Engaging in transactions to make a security appear more actively traded; or
- Rigging quotes, prices, or trades to give the illusion that there is more or less demand for a security than is the case.

Although market manipulation can occur with PFOF, because the payments are a fraction of a penny per share, unless there are millions of shares being traded at a point in time for a given company, the opportunity to affect the firm's price is relatively small. However, if billions of shares of multiple companies in an industry or market segment are being traded in a day, there is the ability to alter the index for that market segment. Even so, market manipulation is usually concerned with the changes in the price of shares for a particular firm. Thus, PFOF is unlikely to be susceptible to significantly increasing or decreasing the stock price of a given company.

Insider Trading Violations

Insider trading is a "malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise nonpublic information which can be crucial for making investment decisions."[110] It is unlikely that PFOF is the cause of insider trading. The individuals who are engaged in PFOF are brokers and market makers. If someone who is a broker or market maker is engaged in insider trading, then they likely received the inside information from a company senior manager who is responsible for maintaining confidentiality. It is possible that a broker or a market maker could receive inside information from a low-level employee, but this would be a very rare event. Brokers and market makers probably do not have the same level of access to information that senior managers possess. Thus, it is unlikely that a security violation based on inside information will occur.

Best Execution Violations

Best execution means that a stock's price is no worse than the NBBO.[111] According to the SEC, stock prices that are less than best execution are an issue.[112] Gensler publicly stated to Barron's that the SEC is considering banning PFOF altogether because the stock prices to investors are allegedly less than best execution.[113] Strangely, Gensler gave no reasons for his assertion.[114] Thus, if there is any security violation that the SEC is focusing on, it is the relationship between PFOF and best execution.

Essay #5 Conclusion

In conclusion, if there is an issue with PFOF, it is because of alleged impropriety. There does not seem to be a high likelihood that PFOF significantly enhances market manipulation and insider trading, but there may be best execution issues. This seems to be the state of the world when dealing with order flows and PFOF.

ESSAY #6: WALL STREET, THE 1987 MOVIE

Wall Street is a film that was released in 1987 that was directed and co-written by Oliver Stone.[115] The movie starred Michael Douglas (Gordon Gekko), Charlie Sheen (Bud Fox), Daryl Hannah (Darien Taylor), and Martin Sheen (Carl Fox). [116]The story is about how Fox, a young stockbroker, becomes entangled with Gekko, a wealthy and

[100]Mark T, Uyeda, Statement on Proposed Rule Regarding Disclosures of Order Execution Information, *U.S. Securities and Exchange Commission* (Dec. 14, 2022), *available at* https://www.sec.gov/news/statement/uyeda-order-execution-20221214.
[101]PS Staff, eBrokers' PFOF Ramps With Increased Trading; A Review of 2Q20 Rule 606 Reports, *Piper Sandler* (Aug. 05, 2020), *available at* https://piper2.bluematrix.com/sellside/EmailDocViewer?encrypt=6470f5cc-e225-497c-922d-e00e6188ed78&mime=pdf&co=Piper&id=FSG-ER@psc.com&source=mail.
[102]SEC Staff, Staff Report on Equity and Options Market Structure Conditions in Early 2021, U.*S. Securities and Exchange Commission* (Oct. 14, 2021), *available at* https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf.
[103]SEC Staff, Press Release: SEC Charges Robinhood Financial With Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution, *U.S. Securities and Exchange Commission* (Mar. 21, 2021), https://www.sec.gov/news/press-release/2020-321.
[104]Maggie Fitzgerald, Robinhood Tanks after SEC Chair Tells Barron's that Banning Payment for Order Flow Is a Possibility, *CNBC News* (Aug. 30, 2021), *available at* https://www.cnbc.com/2021/08/30/robinhood-tanks-after-sec-chair-tells-barrons-banning-payment-for-order-flow-is-a-possibility-.html.
[105]*Id.*
[106]*Id.*
[107]*Id.*
[108]SEC Staff, Market Manipulation, *U.S. Securities and Exchange Commission* (n.d.), *available at* https://www.investor.gov/introduction-investing/investing-basics/glossary/market-manipulation.
[109]*Id.*

[110]ET Staff, What Is "Insider /Trading", *The Economic Times* (n.d.), *available at* https://economictimes.indiatimes.com/definition/insider-trading.
[111]Theresa W. Carey, *supra*, note 92.
[112]SEC Staff, *supra*, note 108.
[113]Maggie Fitzgerald, *supra*, note 104.
[114]*Id.*
[115]Wall Street (Twentieth Century Fox, Amercent Films, & American Entertainment Partners L.P. 1987), *available at* https://www.youtube.com/watch?v=bMoajfjndEo.
[116]*Id.*

unscrupulous corporate raider.[117] Douglas won an Academy Award for Best Actor for his portrayal of Gekko.[118] Gekko seemed to be a composite character based on Ivan Boesky, Carl Ichan, and Michael Ovitz.[119] Terrance Stamp played Sir Lawrence Wildman and was based on Sir James Goldsmith, a British financier.[120] The film has become an archetypal depiction of the corporate excesses that occurred in the 1980s. In 2010, Stone and Douglas made a sequel entitled: *Wall Street: Money Never Sleeps*.[121]

In attempting to appreciate whether Fox's behavior constituted insider trading, a definition of insider trading is necessary to understand. Along with a definition of insider trading, elements of insider trading must be described. If any of the elements of insider trading are not satisfied, then even though some of the elements are satisfied, Fox's conduct will not be classified as insider trading. It should be remembered that in the movie Fox was arrested for insider trading because he engineered that Wildman would buy Bluestar, the airline where his father worked, to save the company from being dismembered.

Definition of Insider Trading

Insider trading is a "malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise non-public information which can be crucial for making investment decisions."[122] Insider trading refers to the "buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security."[123] Insider trading also includes "tipping" of inside information, securities trading by the individual that was "tipped," and securities trading by people who misuse inside information, where tipping is the "act of providing material non-public information about a publicly traded company or a security to a person who is not authorized to have the information with the intent to gain some sort of benefit".[124] Examples of insider trading include "tipping" material non-public information, securities trading by the person who was tipped, and securities trading by individual who misappropriate tipped information.[125]

Examples of insider trading cases that have been brought by the SEC are cases against:[126]

- Corporate officers, directors, and employees that traded the corporation's securities after becoming aware of significant, confidential corporate developments;
- Friends, business associates, family members, and other "tippees" of officers, directors, and employees that traded securities after obtaining insider information;
- Employees of law, banking, brokerage, and printing firms that traded based on inside information that was given to them while providing services to the corporation whose stocks were traded;
- Government employees that traded based on learned confidential information during their government employment;
- Political intelligence consultants who may tip or trade predicated on material, non-public information gotten from government employees; and
- Other persons that misused or exploited confidential information from their employers, family, friends, or others.

The elements of insider trading are (1) a lie or deception, (2) a transgression of a fiduciary obligation (3) the use of secret information about a securities transaction, and (4) willfulness by the defendant.[127] The elements of "tipping" are not prescribed in the statutes, but have evolved through the interpretations of the case law regarding Section 10(b) of the Securities and Exchange Act of 1934. In proving that tipping occurred, the government must show that the tipper (1) possessed material, non-public information, (2) had a duty to maintain the confidentiality of the information, (3) communicated the information to an individual that traded or tipped others to trade, and (4) intended to benefit by giving the tip.[128]

The Plot of the Wall Street Movie

In this section, the essay discusses various instances where Fox commits insider trading. The occurrences are discussed in turn.

First Insider Trading Violation

In 1985, Bud Fox is employed as a junior stockbroker at Jackson Steinham & Co. (Jackson Steinham), a broker-dealer, located in New York City. Fox wanted to work with Gekko who was a well-known financier on Wall Street. For nearly two months, Fox attempted to arrange a meeting with Gekko, but to no avail. On Gekko's birthday, Fox brought Gekko a box of Cuban cigars, whereby Fox obtained the meeting that he desired. After pitching several stocks, Fox provided Gekko with information about Bluestar Airlines (Bluestar), the company where his father is the head of the maintenance workers' union. After some deliberation, Gekko decided to purchase Bluestar and became one of Fox's clients.[129]

This is a classic case of tipping where the elements are all satisfied. Fox possessed material, non-public information from his father regarding Bluestar; As Carl Fox's son and stockbroker, Bud Fox had a duty to maintain the confidentiality of the information; Fox communicated the information to Gekko, an individual that purchased Bluestar stock; and Fox intended to benefit by giving the tip by getting Gekko as a client. Thus, Fox is guilty of tipping.

Second Insider Trading Violation

After making a significant amount of money from the rise of Bluestar stock, Gekko provided some capital for Fox to manage. Fox selected stocks based on honest research but lost money. Gekko asked Fox to spy on Wildman, where Fox opined that Wildman would bid for Anacott Steel (Anacott). Gekko bought a large block of Anacott stock

[117] *Id.*
[118] The 60th Academy Awards, Oscars,org (1988), *available at* https://www.oscars.org/oscars/ceremonies/1988.
[119] James Chen, Gordon Gekko: Wall Street's Most Famous Fictional Character?,*Investopedia* (Oct. 26, 2021), *available at* https://www.investopedia.com/terms/g/gordon-gekko.asp#:~:text=The%20character%20of%20Gordon%20Gekko%20was%20not%20based%20on%20any,Boesky%2C%20and%20investor%20Michael%20Ovitz.
[120] Wall Street, *supra*, note 115.
[121] Wall Street: Money Never Sleeps (Twentieth Century Fox, Pressman Film, & Dune Entertainment 2010).
[122] ET Staff, What Is "Insider /Trading", *The Economic Times* (n.d.), *available at* https://economictimes.indiatimes.com/definition/insider-trading.
[123] SEC Staff, Insider Trading, *U.S. Securities and Exchange Commission* (n.d.), *available at* https://www.investor.gov/introduction-investing/investing-basics/glossary/insider-trading.
[124] Adam Hayes, Tipping: What It Means, How It Works, Example, *Investopedia* (Apr. 29, 2022), *available at* https://www.investopedia.com/terms/t/tipping.asp.
[125] SEC Staff, *supra*, note 123.
[126] *Id.*
[127] *United States v. O'Hagen*, 521 U.S., supra, note 57.
[128] Dixie L Johnson, & Robert Greffenius, Insider Trading by Friends and Family: When the SEC Alleges Tipping, *American Bar Association: Business Law Section* (Aug. 31, 2011), *available at* https://www.americanbar.org/groups/business_law/resources/business-law-today/2011-august/insider-trading-by-friends-and-family/#:~:text=To%20allege%20tipping%2C%20the%20government,that%20the%20tipper%20communicated%20the.
[129] *Id.*

and sold the stock to Wildman at a premium so that Wildman could take over the business.[130]

Again, Fox may have engaged in insider trading if he used his position as a stockbroker to gather material, non-public information about Wildman's actions regarding Anacott. As a stockbroker for Jackson Steinham, Fox may have had a duty to keep the information that Wildman was attempting to buy Anacott secret. Fox told Gekko about Wildman's intentions, thereby satisfying the third element of tipping, Finally, Fox gave Gekko the information with the intent to obtain even more business from Gekko. Thus, Fox is guilty of tipping.

Third Insider Trading Violation

Fox became wealthy, benefitting from his business relationship with Gekko. Fox also gained a girlfriend, Taylor, an interior decorator and Gekko's ex-mistress. Fox used insider information extensively to gain income by employing friends as straw buyers. However, Fox attracted the attention of the SEC because of his questionable transactions.[131] These events are a sequence of insider trading violations. It is presumed that the tipping elements are satisfied because Fox and Gekko became richer as the plot unfolded.

Fourth Insider Trading Violation

Fox suggested that Gekko buy Bluestar and expand the organization, making Fox the CEO by using the savings from union concessions and an overfunded pension. Fox gained union support for the deal, but as the deal progressed, Fox discovered that Gekko wanted to sell off the company assets to access the firm's pension fund, leaving the employees without jobs. Fox is riddled with remorse and guilt, deciding to thwart Gekko by leaking his plans to the media, thereby driving up the price of the Bluestar's stock. Fox then secretly met with the union presidents and Wildman, orchestrating a transaction where Wildman buys Bluestar. The next day, Fox went to his office, where he was arrested for insider trading.[132]

Here, Fox engaged in several insider trading violations. By employing insider information, Fox was able to induce Gekko to buy Bluestar. Before the purchase was completed, Fox again used insider information to ensure that Wildman bought Bluestar, thereby saving the company and the jobs of its employees. Although Fox's intentions were admirable, his methods were illegal. Thus, Fox was again guilty of insider trading.

Vindication Attempt

Later, Fox and Gekko met in Central Park, where Gekko recounted many of his illegal trades. Fox wore a wire so that the conversation was recorded. There was no insider trading during Fox's encounter with Gekko. Rather, it was an attempt by Fox and the SEC to get Gekko to confess to his crimes to a so-called confidant. Although Fox's parents were proud of him, Fox had committed numerous insider trading violations and was liable for criminal prosecution.

Essay #6 Conclusion

In conclusion, Fox was guilty of numerous insider trading violations. Although his attempt to implicate Gekko was commendable, it did not prevent him from going to prison for insider trading. The movie ended with Fox walking up the courthouse stairs, demonstrating to the viewing public that eventually criminals are caught, and that crime does not pay. It was an appropriate ending.

CONCLUSION

The purpose of this article was to connect six essays that ranged from *The Numbers Game* talk by Arthur Levitt in 1998 that suggested that the SEC should pay more attention to earnings management issues and the illusions that accounting firms employed to disguise financial volatility to the insider trading violations exemplified in the 1987 movie *Wall Street*. The idea behind the article was to link the six topics together. There is a definite link between the first essay and the second essay, which dealt with materiality. There is also a link between the notion of materiality and the different theories of liability, which was discussed in the third essay. The fourth essay considered what to do if an organization receives a subpoena from the SEC. The fifth essay discussed order flows, and the issues surrounding the potential for financial hanky-panky. It should be remembered that PFOF can result in security law violations if market manipulation or insider trading occurs. The final essay is an analysis of the insider trading violations that were graphically displayed in the 1987 movie entitled *Wall Street*.

The relationship between these six essays ebbs and flows, depending on the strength of the topic examined. In essence, it is probably better if the reader views each essay on its own merits, rather than attempting to form a continuous chain of ideas. In this way, the essays may help the reader appreciate the value of each topic, as well as see the financial big picture. Things that sometimes appear disconnected can take on a life of their own. This is the intent in creating this anthology.

Donald L. Buresh Biography

Donald L. Buresh earned his Ph.D. in engineering and technology management from Northcentral University. His dissertation assessed customer satisfaction for both agile-driven and plan-driven software development projects. Dr. Buresh earned a J.D. from The John Marshall Law School in Chicago, Illinois, focusing on cyber law and intellectual property. He also earned an LL.M in intellectual property from the University of Illinois Chicago Law School (formerly, The John Marshall Law School) and an LL.M. in cybersecurity and privacy from Albany Law School, graduating summa cum laude. Dr. Buresh received an M.P.S. in cybersecurity policy and an M.S. in cybersecurity, concentrating in cyber intelligence, both from Utica College. He has an M.B.A. from the University of Massachusetts Lowell, focusing on operations management, an M.A. in economics from Boston College, and a B.S. from the University of Illinois-Chicago, majoring in mathematics and philosophy. Dr. Buresh is a member of Delta Mu Delta, Sigma Iota Epsilon, Epsilon Pi Tau, Phi Delta Phi, Phi Alpha Delta, and Phi Theta Kappa. He has over 25 years of paid professional experience in Information Technology and has taught economics, project management, negotiation, managerial ethics, and cybersecurity at several universities. Dr. Buresh is an avid Chicago White Sox fan and keeps active by fencing épée and foil at a local fencing club. Dr. Buresh is a member of the Florida Bar.

[130] *Id.*
[131] *Id.*
[132] *Id.*

LIST OF ABBREVIATIONS

Abbreviation	Abbreviation Description
AICPA	American Institute of Certified Public Accounts
Anacott	Anacott Steel
CEO	Chief Executive Officer
CFO	Chief Financial Officer
DBRS	Dun & Bradstreet Rating Service
Enron	Enron Corp.
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
Jackson-Steinham	Jackson-Steinham& Co.
MCI WorldCom	WorldCom, Inc.
NBBO	National Best Bid and Offer
PCOAB	Public Company Accounting Oversight Board
PFOF	Payment for Order Flows
SAB 99	SEC Staff Accounting Bulletin No. 99
SCOTUS	Supreme Court of the United States
SEA34	Securities Exchange Act of 1934
SEC	Securities and Exchange Commission
SOX	Sarbanes-Oxley Act of 2002
UUNET	UUNET Technologies
WorldCom	WorldCom, Inc.

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